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STATE FOR EAP/CM AND EEB/OMA, TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ECON EFIN EINV HK CH
SUBJECT: PRO-BEIJING CHINESE PRESS IN HONG KONG BLAME U.S. INSTITUTIONAL INVESTORS FOR "EXPORTING SUBPRIME CRISIS"

REF: A. HONG KONG 1679
B. HONG KONG 1688

¶1. Summary: Hong Kong's Hang Seng Index (HSI) closed slightly down on September 12 and lost almost 3 percent during the trading week. Two local pro-Beijing newspapers blamed U.S. and other Western financial institutions for exacerbating recent downturns in global financial markets, as they liquidate foreign assets and retreat into their home markets. The dailies singled out the United States for "exporting its subprime crisis." Several Hong Kong financial institutions initiated efforts to boost their liquidity, fearing contagion from problems on Wall Street. In his weekly column, Hong Kong Monetary Authority Chief Executive Joseph Yam explained that Hong Kong's mortgage market remained sound, due to prudent lending standards and the structural strength of the Hong Kong Mortgage Corporation (HKMC). A former senior official at the HKMC urged Hong Kong monetary authorities to use turbulent global market conditions to boost Hong Kong's share of global bond issuances. End summary.

Hang Seng Index Down 3 Percent For Week Ended September 12

¶2. The USG's decision to assume control over the operations of Fannie Mae and Freddie Mac pushed up the Hang Seng Index by 860 points on Monday (ref A), but the gains were wiped out in the following three days, as fund managers commenced a major sell-off (ref B). On September 12, the HSI opened 44 points higher, but got no support until it turned downward to 19,158, an 18-month low. The HSI closed at 19,352.90, down 0.2 percent for the day. The HSI declined 2.9 percent for the week and has dropped 30 percent thus far in 2008.

HIBOR was quoted by Hang Seng Bank at 4:30 pm at 1.45 percent for overnight, 1.78 percent for one-month, 2.23 percent for three-months, and 2.50 percent for six-months.

U.S. Institutions "Exporting Subprime Crisis"

¶3. Two pro-Beijing dailies, Ta Kung Pao and Wen Wei Po, blamed U.S. institutional investors for "exporting the subprime (mortgage) crisis." A September 12 editorial in Wen Wei Po said U.S. investment funds were cashing in their stocks and leaving Hong Kong, due to redemptions and other liquidity requirements in the United States. The daily said their "dumping" of Mainland property, natural resource, and infrastructure stocks was creating "domino effects" in local markets. The Wen Wei Po editorial said big local players in the Hong Kong stock market, who were formerly positive about China's economic situation and Hong Kong stocks, were forced to follow others and cut their holdings of shares traded on

the Hang Seng. (Note: Tycoon Lee Shau-kee, Chairman of Henderson Land Development, recently admitted to the press that he has lost billions of Hong Kong dollars in his local shareholdings.)

¶4. An editorial in the Ta Kung Pao daily on September 12 said foreign investment funds were dumping shares "in a crazy way," pushing the HSI lower. A commentary in Ta Kung Pao warned local investors that foreign investment funds wanted to hold a greater proportion of cash, as a "global financial tsunami" might appear. The newspaper criticized the withdrawal of cash by U.S. institutions from emerging markets, saying they were "exporting economic recession to the world."

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Local Banks Seek to Boost Liquidity and Capital
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¶5. Though some reports said the USG would consider rescuing Lehman Brothers from bankruptcy/liquidation as they did with Bear Stearns, investor confidence remained fragile, and bankers in Hong Kong started to exhibit signs of concern about liquidity. Citigroup in Hong Kong placed a front-page advertisement in the Chinese language press (Hong Kong Economic Journal, September 10), saying it would offer 3.5 percent annual interest on new Hong Kong dollar deposits. China Merchant Bank announced on September 12 that it would delay the acquisition of Wing Lung Bank from September 14 to October 27 and raise RMB 30 billion by issuing subordinated bonds to reinforce its capital base. The Bank of East Asia took the lead this week to file court applications in Hong

Kong and the Mainland for the liquidation of Peace Mark, a locally-listed watch retailer with financial problems.

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Senior Officials Highlight Hong Kong's Strengths
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¶6. Responding to the poor market sentiment, Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam sought to reassure Hong Kong investors that the problems of Fannie Mae and Freddie Mac would not appear in the Hong Kong Mortgage Corporation. Yam said in his weekly column published on September 11, "Fannie Mae and Freddie Mac, with the help of numerous mortgage brokers, originates mortgages, in direct competition with the banks. But the Hong Kong Mortgage Corporation does not directly originate mortgages. It buys mortgages from banks which want to obtain liquidity or reduce their exposure to mortgages. Without competition from Government Sponsored Enterprises (GSE), and encouraged by supervisory requirements, banks in Hong Kong are able to maintain prudent underwriting standards, including notably the 70 percent loan-to-value ratio." Yam noted that the Hong Kong Mortgage Corporation's (HKMC) role, operations and governance arrangements are very different from Fannie Mae and Freddie Mac.

¶7. A former senior official of the HKMC, Philip Li, told television interviewers on September 12 that the current financial crisis has been developing into a confidence crisis, with bankers nervous and not be willing to offer three-month loans to each other. According to Li, three-month HIBOR could no longer be treated as an indicator for interbank borrowings, as one week or two week interbank loans were long enough for many lenders. Li, an expert in the debt issuance business, suggested the HKMA strengthen Hong Kong's role as a regional financial center by developing the Asian bond market, thereby providing global markets with needed liquidity. He said the current financial crisis in the United States might provide a good opportunity for Hong Kong to gain a market niche in the global bond market.
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